ST 02-27
Tax Type: Sales Tax
Issue: Computer Software Exemption
Agricultural Machinery/Feed/Products/Exemptions

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	)	
	)	**Docket No. 00-0000000**
v.	)	**IBT # 0000-0000**
	)	**NTL #00-000000000000000**
ABC COMPUTERS, LTD.	)	**NTL #00-000000000000000**
	)	
Taxpayer	)	

RECOMMENDATION FOR DISPOSITION

Appearances: Kent Steinkamp, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Lars Eric Ostling of Ostling & Associates and Lawrence J. Czepiel, Attorney at Law, for ABC Computers, Ltd.

Synopsis:

The Department of Revenue ("Department") conducted an audit of ABC Computers, Ltd. ("taxpayer") that resulted in the issuance of two Notices of Tax Liability ("Notices"). The Notices assessed additional tax, interest, and penalties, including a fraud penalty. The taxpayer timely protested the Notices. A hearing was held during which the parties raised the following issues: (1) whether the audit period began on January 1, 1991 or January 1, 1992; (2) whether the Department's method for determining the audit liability met a minimal standard of reasonableness; (3) whether the software that the taxpayer sold is exempt from the retailers' occupation tax ("ROT") because it was licenses of software; (4) whether the software that the

taxpayer sold qualifies for an exemption from ROT on the basis that it was custom software; (5) whether certain sales are exempt from ROT on the basis that they were out-of-state sales; (6) whether the sales of yield monitors qualify for the agricultural equipment exemption; (7) whether certain receipts are reimbursement for insurance; (8) whether certain payments are nontaxable payments for hardware/software support; and (9) whether the fraud penalty should be imposed. After reviewing the record, it is recommended that this matter be resolved partially in favor of the taxpayer and partially in favor of the Department.

FINDINGS OF FACT:

1. The taxpayer sells software programs to agricultural businesses such as grain developers and seed companies. (Tr. p. 122)

2. The Department audited the taxpayer for the period of January 1, 1992 through December 31, 1994. (Dept. Ex. #8; Tr. pp. 455-456)

Audit Methodology:

3. The auditor conducted a detailed audit of the taxpayer's books and records that were provided by the taxpayer through the Department's Bureau of Criminal Investigation ("BCI"). (Tr. pp. 49-52)

4. The auditor did not personally contact the taxpayer because she said that the audit was under the BCI. Jack Lehman, an investigator for BCI, contacted the taxpayer. (Tr. pp. 46-47)

5. The auditor contacted four of the taxpayer's customers during the audit. The auditor did not look at the actual software running on the customers' computers. The auditor asked the customers whether they installed the software, whether someone else had to go to the customers' location to install it, and whether the customers had to do extensive work. (Tr. pp. 42-45)

6. Most of the customers that the auditor contacted were not continuing to use the software and did not have copies of it in their possession. (Tr. p. 45)

7. The auditor was not provided documentation to show that the software was custom software. She only had an invoice for custom software and no other documentation. (Tr. p. 47)

8. The auditor did not have a diskette of the software and did not look at a printout of the software. (Tr. p. 48)

Licenses:

9. The taxpayer presented licenses that were signed by several of its customers. Only two of the licenses were dated. One was dated April 1, 1989, and another was dated April 10, 1996. (Taxpayer Ex. #10; Tr. pp. 397-407)

10. The taxpayer did not present licenses for several customers who purchased software during the audit period. (Dept. Ex. #2; Taxpayer Ex. #10)

Software:

11. At the time of the audit, the taxpayer had approximately 35 to 40 agriculture-related customers. (Tr. p. 136)

12. When the taxpayer sells software to a customer, the taxpayer also sells to the customer an operating system called "ABC." The taxpayer collects tax on the operating system. The taxpayer acquires the operating system from ABC Software Corporation. (Tr. pp. 110, 115, 117)

13. The operating system is a program that sets up the hardware to allow a specific software program to run on the machine. The taxpayer occasionally makes changes to the operating system, usually with the assistance of ABC Software Corporation. (Tr. pp. 116, 118-119)

14. ABC has a software plug that comes with it. The plug goes into the parallel port on the back of the computer, and if the plug is not in place or is disconnected, the machine will not

operate. The plug is used so that the operating system is not copied or distributed without a license. (Tr. p. 114)

15. If the customer purchased a new computer, the taxpayer would have to install ABC on the new computer because it cannot be transferred from one computer to another. (Tr. p. 244)

16. ABC is a complex operating system that requires specifically written software in order to allow for multiple users. Software for ABC can only be purchased from one of its distributors. The taxpayer sells the software that runs on ABC. A "canned" or off-the-shelf software program from companies such as Best Buy or Circuit City cannot run on ABC. (Tr. pp. 122-123, 130-32)

17. The taxpayer obtained the programs for ABC from XXX Data Services. (Tr. pp. 176, 433, 442)

18. The taxpayer starts with an original or base program from XXX Data Services that has six categories of programs: accounts receivable, accounts payable, grain, general ledger, inventory, and fix programs. The taxpayer has to modify the programs for each customer. (Tr. pp. 176-179, 185)

19. The taxpayer does not provide a diskette with the software that it sells to its customers because the software is installed on the computer. The taxpayer sells the rights to use the software. (Tr. pp. 259, 262)

20. Most of the software programs that the taxpayer sold would not operate on ABC without first being modified by the taxpayer. (Tr. pp. 441, 446-449)

21. The taxpayer has written a total of 2,217 different programs to run on ABC for various customers. (Taxpayer Ex. #8; Tr. pp. 133-34, 315-318)

22. It takes the taxpayer approximately 8 to 10 hours to install a basic version of software to run on ABC because of the complexity of the system and the nature of agricultural businesses. (Tr. p. 141)

23. The installation of the software is not a quick process because accounting methods for agricultural businesses vary from state to state and vary within the regions of the state. For example, some elevators take a moisture discount on grain that is brought in to purchase. Others will shrink and dry the grain. Central Illinois is the only region that averages the grades on grain brought in. (Tr. pp. 141-144)

24. The accounting practices concerning discounts also vary within the industry. The amount of the discount and the time allowed for paying may differ. Sometimes a business may give an individual customer a different discount than other customers. (Tr. pp. 145-146)

25. Prior to installing the program, the taxpayer has a list of "start-up questions" that it asks the customer. The questions include, for example, do you use purchase orders, do you want to use purchase orders, do you want to track history on purchases from vendors, do you want to track history for customers, and do you want breakdowns of general ledger account summaries. (Taxpayer Ex. #6; Tr. pp. 200-202)

26. The purpose of the questions is to obtain an idea as to how the customer does business and what they want the software to do for the business. The taxpayer's goal is to make the software do what the company has always done. (Tr. p. 228)

27. The taxpayer visits the customer's site and asks them the start-up questions. The process of determining what the customer needs could take up to three weeks. (Tr. p. 228)

28. The taxpayer's customers can be divided into four general categories: (1) grain elevators; (2) trucking companies; (3) hog farmers; and (4) fertilizer dealers. (Tr. p. 362)

29. One of the taxpayer's customers, Anywhere Grain Company, is a grain elevator that buys and sells corn. (Tr. p. 205)

30. The taxpayer presented a printout of two of the programs that were written for Anywhere Grain. The taxpayer wrote a total of 832 programs for this customer. The taxpayer explained that its programming is different from the data entry that is needed for off-the-shelf software because the taxpayer changes the fields of the program to allow the customer to type in the necessary data. The taxpayer's program tells the computer how to build a screen to allow the user to input information. (Taxpayer Ex. #1; Tr. pp. 151-153, 157, 161-162)

31. The taxpayer did not add information into the computers concerning Anywhere Grain's customers. The taxpayer simply changed the program to allow for the entry of the information. The data entry for Anywhere Grain's computers could only be done once the taxpayer completed all of its programming. (Tr. pp. 158, 161-162)

32. For Anywhere Grain, the taxpayer started with the original grain program and nearly completely rewrote it to allow for editing, averaging, and recomputing. The changes allowed more flexibility for the uses of the software. Grain programs require a higher volume of changes and more record-keeping changes. (Tr. pp. 185-189, 193)

33. Of the 832 programs written for Anywhere Grain, none of the programs were "off-the-shelf." The taxpayer made changes or added various fields to each of the programs. The taxpayer explained what changes were made to the programs for Anywhere Grain. (Tr. pp. 158; 161-166, 179-191)

34. The taxpayer spent approximately three months making all of the program changes for the 832 programs for Anywhere Grain. The taxpayer charged the customer $14,250 for those changes. (Dept. Ex. #11; Tr. pp. 195-196, 341)

35. In the process of changing the product, the taxpayer spent approximately three to four months of non-programming time at Anywhere Grain. The taxpayer spent this time training, reviewing how they did business, and reviewing changes. (Tr. pp. 232-234)

36. For Anywhere Grain, the taxpayer gave the percentages of modifications that the taxpayer wrote for each of the programs. These modifications consisted of either a rewritten code or a code added to the original programs. Most of the percentages were well over 50%. The taxpayer spent approximately three to four months making these changes. (Tr. pp. 332-341, 431-432)

37. Another one of the taxpayer's customers, XYZ Trucking ("XYZ"), is a trucking, fertilizer and chemicals company. (Tr. p. 206)

38. The taxpayer presented a printout of a program that it wrote for XYZ and explained the changes that were made to that program. (Taxpayer Ex. #2; Tr. pp. 191-199, 365

39. The taxpayer charged XYZ a total of $12,750 for installing and making changes to its software. (Taxpayer Ex. #17; Tr. p. 208)

40. For XYZ, the taxpayer gave the percentages of modifications that the taxpayer wrote for each of the programs. These modifications consisted of either a rewritten code or a code added to the original programs. Most of the percentages were well over 50%. (Tr. pp. 365-376, 431-432)

41. Another one of the taxpayer's customers is Doe Brothers, which operates a grain elevator. Unlike Anywhere Grain, which has one location, Doe Brothers has four locations. Doe Brothers also handles specialty commodities, such as high oil corn and white corn. (Tr. pp. 219-220)

42. Doe Brothers needed a program for each different commodity and each of the four locations. Each of the other programs, such as the general ledger programs, needed to be changed accordingly. (Tr. pp. 220-224)

43. Doe Brothers was charged $17,125 for these changes. The taxpayer spent approximately 450 to 500 hours making the changes to these programs. (Taxpayer Ex. #17; Tr. pp. 225-226)

44. Another one of the taxpayer's customers is MMMMM Brothers Grain & Feed ("MMMMM"), which operates a hog farm and is a feed manufacturer. They manufacture feed for farmers and for their own livestock. They handle hogs and store grain for their own purposes. (Tr. pp. 263-265)

45. The taxpayer wrote 28 livestock programs for MMMMM that tracked what feed went to what bins for each of MMMMM's customers. They also identified the hogs by groups and tracked how much was earned from those hogs. The changes made to these programs affected the other categories of programs: accounts receivable, accounts payable, and inventory. (Taxpayer Ex. #7; Tr. pp. 263, 271-275)

46. The programs that the taxpayer wrote for MMMMM concerned, for example, the buying and selling of feed and the mixing of feed. They also concerned MMMMM's use of the feed and MMMMM's customers' use of the feed. The programs concerned the buying and selling of hogs. (Tr. pp. 276-277)

47. For MMMMM, the taxpayer wrote 28 livestock programs, 103 installation programs, 318 grain programs, 243 accounts receivable, 95 accounts payable, and 150 inventory for a total of 937 programs. (Tr. p. 280)

48. The taxpayer explained the specific changes made to one of MMMMM's livestock programs. For all of the livestock programs, the taxpayer gave the percentages of original programming that the taxpayer wrote for these programs. These percentages averaged approximately 74%. It took the taxpayer approximately three weeks to make these changes. (Taxpayer Ex. #7; Tr. pp. 297-301, 305-309)

49. The taxpayer gave the percentages of original programming that was written for the remainder of MMMMM's programs. These modifications consisted of either a rewritten code or a code added to the original programs. Most of these percentages were well over 50%. (Tr. pp. 309-325, 431-432)

50. Another one of the taxpayer's customers is Old McDonald's Farms, a fertilizer and grain company. (Tr. p. 394)

51. The taxpayer spent approximately 1200 hours making changes to the orginal base program that it sold to Old McDonald's. Approximately 98.5% of the base programs were changed to meet the customer's needs. (Tr. p. 396)

52. The taxpayer did similar modifications to the software that it sold to its remaining customers. (Tr. p. 397)

53. The taxpayer presented invoices for software that allegedly included payments that were taxed twice by the Department.[1] The auditor did not double tax these payments. (Taxpayer Ex. #16; Tr. pp. 424-425, 451, 460-462)

Out-of-state Sales:

54. The Department concedes that it should have allowed an exemption for out-of-state sales for three invoices, numbers 356, 518, and 541. These invoices represent total sales of $3,779.50. The Department concedes that this should be subtracted from the total taxable sales that are the basis for the audit liability. (Dept. brief p. 13)

Yield Monitors:

55. The taxpayer presented three invoices that total $10,490.00 and are for the sale of yield monitors to the taxpayer's customers. (Taxpayer Ex. #12; Tr. pp. 420-421)

Insurance:

56. One of the taxpayer's employees, Jane Doe, left the taxpayer to work for one of the taxpayer's customers, Joe Blow Grove Grain. The taxpayer kept the employee on its insurance until she could be included on Joe Blow Grove Grain's insurance. The taxpayer provided ten invoices for Joe Blow Grove Grain that were reimbursements for the insurance premiums. (Taxpayer Ex. #15; Tr. pp. 381-382, 423)

Hardware Maintenance:

57. The taxpayer presented invoices for hardware maintenance for some of its customers. All of the invoices included hardware maintenance fees that were charged for year-long service. For example, invoice number 380 was for hardware maintenance for a customer for the period of 5/15/92 to 5/14/93 in the amount of $3,353.70. The invoices dated during the audit period had a total of $52,077.03 for hardware maintenance fees. (Taxpayer Ex. #13; Tr. p. 421)

Software Support:

58. The taxpayer presented invoices for software support that were issued during the audit period. All of the invoices for software support fees were for year-long service. For example, invoice number 335, dated January 3, 1992, was for software support for a customer for the period from 12/15/91 to 12/14/92 in the amount of $600. The invoices that the taxpayer presented that are dated during the audit period have a total of $65,850 for software support fees. The taxpayer charged one of the following fees for yearly software support service: $600, $750, $900, $1050, or $1200. (Taxpayer Ex. #14; Tr. p. 422)

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[1] The taxpayer did not raise this issue in its brief.

59. The invoices that were for software support were for phone calls, labor, training, and anything else to help the customer use the software. (Tr. pp. 209-212, 215, 422)

Fraud Penalty:

60. The taxpayer pled guilty to a criminal charge that was based in part on the fact that the taxpayer collected tax on the sale of the ABC operating system but failed to remit it to the Department. (Tr. pp. 132-33)

61. The Department assessed a fraud penalty against the taxpayer. One of the reasons for the penalty was that the amount that the taxpayer showed as collected ROT on its invoices was not accurately reflected on its tax returns for 1992 and 1993. The Department determined that the taxpayer collected approximately $25,000 of ROT during the audit period but only remitted $139. (Tr. pp. 29-35; Dept. Ex. #6)

62. The Department prepared corrected tax returns for the period of January 1, 1992 through November 30, 1993 and December 1, 1993 through December 31, 1994. The first return shows tax due in the amount of $29,956 plus a penalty of $8,987. The second return shows a tax due of $20,054, late filing penalty of $897, late payment penalty of $3,008, and fraud penalty of $1,059. A copy of the corrected returns was admitted into evidence under the certificate of the Director of the Department. (Dept. Group Ex. #8)

CONCLUSIONS OF LAW:

The Retailers' Occupation Tax Act ("ROTA") (35 ILCS 120/1 *et seq.*) imposes a tax upon persons engaged in the business of selling at retail tangible personal property. 35 ILCS 120/2. Sections 4 and 5 of the ROTA provide that the certified copy of the corrected return issued by the Department "shall be prima facie proof of the correctness of the amount of tax due, as shown therein." 35 ILCS 105/12; 120/4; 120/5. Once the Department has established its *prima facie*

case by submitting the corrected return into evidence, the burden shifts to the taxpayer to overcome this presumption of validity. A.R. Barnes & Co. v. Department of Revenue, 173 Ill.App.3d 826, 832 (1st Dist. 1988). To prove its case, a taxpayer must present more than its testimony denying the accuracy of the Department's assessment. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill.App.3d 203, 217 (1st Dist. 1991). The taxpayer must present sufficient documentary evidence to support its claim. Id.

It is well-settled that tax exemption provisions are strictly construed in favor of taxation. Heller v. Fergus Ford, Inc., 59 Ill.2d 576, 579 (1975). The party claiming the exemption has the burden of clearly proving that it is entitled to the exemption, and all doubts are resolved in favor of taxation. Id.

Issue One

During the hearing, the parties became aware of a discrepancy concerning the starting date for the audit period. The Department had issued two Notices of Tax Liability to the taxpayer, and the first Notice states that the taxpayer's account was audited for the period of January 1, 1991 to November 30, 1993. The second Notice indicates an audit period of November 30, 1993 to December 31, 1994. The corrected returns prepared by the auditor indicate that the audit period began on January 1, 1992 rather than January 1, 1991.

The Department contends that the first Notice simply misstated the starting date. The Department notes that the amounts assessed on the Notices matches the amounts on the corrected returns, and therefore there is no meaningful distinction to be drawn by the discrepancy. The taxpayer contends that the audit period began on January 1, 1991, and any tax, penalty, and interest from the period of January 1, 1991 to December 31, 1991 should be dismissed.

The first corrected return prepared by the Department shows a tax deficiency in the amount of $29,956 and a penalty in the amount of $8,987 for the period from January 1, 1992 to November 30, 1993. The first Notice of Tax Liability that indicates an audit period of January 1, 1991 to November 30, 1993 states that the tax due is $29,956 and the penalty due is $8,987. The figures on the second corrected return and Notice also match. The total amount of tax on the Notices equals the total amount of tax on the corrected returns. I conclude that the beginning audit date on the Notice was a scrivener's error on the part of the Department. The error is not material because the corrected returns indicate that the full amount of the assessed tax is based on the time period from January 1, 1992 to December 31, 1994. The Department has not assessed any tax for the period of January 1, 1991 to December 31, 1991. It is therefore not necessary to dismiss the portion of the assessment related to that time period because none exists.

Issue Two

The taxpayer contends that the auditor acted in an arbitrary and unreasonable manner when she conducted the audit in this case and that the auditor's method failed to meet a minimum standard of reasonableness. The taxpayer notes that the auditor testified that the audit was done in response to a request from Jack Lehman of the Bureau of Criminal Investigation. The auditor conducted the audit based on the taxpayer's documents received from BCI. The auditor testified that Mr. Lehman and the auditor's supervisor determined that the software was not custom software. (Tr. p. 46). The auditor stated that this conclusion was reached because the Department did not receive paperwork from the taxpayer indicating that the software was custom-made. (Tr. p. 47) The auditor stated that she only had invoices from the taxpayer that stated that the software was custom software, and the auditor received no other documentation from the taxpayer supporting its position. (Tr. p. 47)

When questioned further, the auditor testified that she had "no idea" whether Mr. Lehman looked at the taxpayer's software, and she had "no idea" whether Mr. Lehman thought the software was custom software. (Tr. p. 51) The auditor also testified that her supervisor did not look at the software. (Tr. pp. 46, 48) The auditor stated that her supervisor's determination that the software was not custom-made was based solely on what Mr. Lehman and the auditor told the supervisor. (Tr. p. 48) The auditor stated that she did not take a diskette from the taxpayer and did not look at a printout of the software because it was not provided by the taxpayer. (Tr. p. 48) When asked whether this information had been requested from the taxpayer, the auditor said she was not sure what Mr. Lehman had requested from the taxpayer. (Tr. pp. 48-49)

Another basis for the taxpayer's contention that the audit was unreasonable was the fact that the auditor did not contact the taxpayer's customers by mail to determine whether they thought the software was custom-made. The auditor contacted four customers of the taxpayer, but could not remember the names of two of the customers. (Tr. p. 42) Of the two that she could remember, she did not review the software with them and did not look at the software. (Tr. p. 44) She said that most of the places that she contacted were not still using the software. (Tr. p. 45)

The Department states that the auditor indicated that she did not see any documentation from the taxpayer that showed that the software was not taxable even though the auditor conducted a detailed audit of the taxpayer's books and records. The Department contends that the taxpayer was asked to produce and certify that it presented all of its books and records for the audit period. The Department argues that because the auditor's primary method was to examine all of the taxpayer's available books and records in detail and this method was the basis for

arriving at the figures on the corrected return, this method could not have been more precise. In addition, the Department notes that the auditor randomly sampled customers to see whether it was possible to construct sufficient documentation to support the taxpayer's claim that the software was custom-made. The Department contends that without additional information, the auditor fairly concluded that the taxpayer owes the additional tax on the corrected return, and her method for determining this was reasonable.

The Department is required to correct the tax return according to its "best judgment and information." 35 ILCS 120/4. There is no requirement that the Department substantiate the basis for its corrected return at the hearing. Masini v. Department of Revenue, 60 Ill.App.3d 11, 14 (1st Dist. 1978). When the corrected return is challenged, however, the method that was used by the Department in correcting the return must meet some minimum standard of reasonableness. Id.; Elkay Manufacturing Co. v. Sweet, 202 Ill.App.3d 466, 470 (1st Dist. 1990).

Section 7 of the ROTA provides in part as follows:

> "To support deductions made on the tax return form, or authorized under this Act, * * * on account of receipts from any other kind of transaction that is not taxable under this Act, entries in any books, records or other pertinent papers or documents of the taxpayer in relation thereto shall be in detail sufficient to show the name and address of the taxpayer's customer in each such transaction, the character of every such transaction, the date of every such transaction, the amount of receipts realized from every such transaction and such other information as may be necessary to establish the non-taxable character of such transaction under this Act." 35 ILCS 120/7.

The books and records that were available to the auditor did not contain sufficient information to establish the non-taxable nature of the transactions as required under section 7. The auditor performed a detailed examination of the books and records that were provided by the taxpayer, and the auditor stated that she did not receive documentation indicating that the taxpayer's software was exempt from taxation as custom software. Although it is not clear whether the

Department asked the taxpayer for additional information to substantiate its claim that the software was custom-made, the record indicates that the auditor performed the audit according to the best information that was available to her. The taxpayer did not provide any evidence indicating that additional information was provided to the Department during the audit but not reviewed by the Department. Because the taxpayer's records were inadequate, under these circumstances, the auditor's method was minimally reasonable.

Issue Three

The Department's regulation concerning computer software provides in part as follows:

"1) A license of software is not a taxable retail sale if:

A) it is evidenced by a written agreement signed by the licensor and the customer;

B) it restricts the customer's duplication and use of the software;

C) it prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;

D) the licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or of permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor's books and records, or supported by a notarized statement made under penalties of perjury by the licensor; and

E) the customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

EXAMPLE: A retailer of computer software and related products sells or transfers a shrink-wrapped software program to a customer. A "license agreement" contained on or in the package, which by its terms becomes effective upon opening of the package, states that the customer does not receive title to the program and that the customer may not copy the program except to make a backup or archival copy while he owns the program. The license agreement is not evidenced by a written agreement signed by the customer. The license does not

> prohibit the customer from selling the program to a third party. If the customer loses or damages the program, the vendor will not replace it free or for a minimal charge. Since it fails to meet all the requirements for treatment as an exempt license, the transfer from the vendor to the customer is a taxable retail sale of software." 86 Ill.Admin.Code §130.1935(a)(1).

The Department contends that the signed, undated licenses presented by the taxpayer at the hearing do not present a basis for finding the software sales not taxable. The Department claims that the taxpayer admitted that the written licenses did not exist at the time that the sales took place. Also, the Department contends that the taxpayer's witness could not state that they existed in that form during the audit period. The Department argues that the taxpayer's position is ludicrous because no agreement was evidenced by a written document at the time of the transaction. The transactions were not licenses at the time of the sale because they were not evidenced at that time by written agreements.

The taxpayer claims that it licensed the software to the agribusiness users and that the agreements were printed on the order form and given to the purchaser at the time of delivery. The taxpayer also contends that the license agreement, except for a few minor changes, was the same basic agreement that the taxpayer had used since 1986. (Tr. p. 409) The taxpayer claims that there were signed licenses, and the Department's regulation does not require a date on the written agreement. The taxpayer's witness testified that the license agreement was in conformance with the Department's regulation, and the taxpayer claims that the Department did not rebut this evidence. The taxpayer contends that the Department's only challenge to the agreements is that they were not dated.

The taxpayer presented licenses for 32 of its customers (Taxpayer Ex. #10). The taxpayer and its customers signed the written agreements, and the agreements contain provisions that comply with the requirements listed in the Department's regulation (86 Ill.Admin.Code

§130.1935(a)(1)). The taxpayer's sole witness, Jennie Doe, did not know whether the agreements were signed during the audit period (Tr. p. 440). Ms. Jennie Doe did not specifically state that the agreements were the same agreements that were used since 1986, as taxpayer's counsel suggests; she testified that a different document, which was a customer order form, had not changed since 1986 (Tr. p. 409).

Of the 32 licenses presented by the taxpayer, all but two of them do not have dates on them. The two that have dates are dated April 1, 1989 and April 10, 1996, which are outside the audit period. More importantly, the taxpayer did not present licenses for a number of customers who purchased software during the audit period.[2] (See Dept. Ex. #2; Taxpayer Ex. #10) Most of the licenses presented by the taxpayer are for customers who were not customers during the audit period. Without the licenses, it cannot be found that the taxpayer met its burden of proving the sales were not taxable retail sales. With respect to the licenses that were presented for customers who purchased software during the audit period, it was not clear from the testimony whether these licenses were provided at the time of the sale. (Tr. pp. 440, 468-469) The sales of software are therefore not exempt on this basis.

Issue Four

The ROTA provides that "computer software shall be considered to be tangible personal property." 35 ILCS 120/2-25. The Act further provides as follows:

> "Computer software. For the purposes of this Act, "computer software" means a set of statements, data, or instructions to be used directly or indirectly in a computer in order to bring about a certain result in any form in which those statements, data, or instructions may be embodied, transmitted, or fixed, by any method now known or hereafter developed, regardless of whether the statements, data, or instructions are capable of being perceived by or communicated to humans, and includes prewritten or canned software that is held for repeated sale or lease, and all associated documentation and materials, if any, whether

[2] The customers for which the taxpayer did not provide licenses include the following: XXX Farm Service, XXX Elevator, XXX Grain Company, XXX Grain Company, XXX Elevator Company, and XXX Agri Corporation.

contained on magnetic tapes, discs, cards, or other devices or media, **but does not include software that is adapted to specific individualized requirements of a purchaser, custom-made and modified software designed for a particular or limited use by a purchaser, or software used to operate exempt machinery and equipment used in the process of manufacturing or assembling tangible personal property for wholesale or retail sale or lease**." (emphasis added, 35 ILCS 120/2-25).

In addition to the statute, the Department's regulation concerning computer software provides in part as follows:

c) Custom Computer Programs

1) Custom computer programs prepared to the special order of the customer are not subject to tax under the [ROTA] ***. To be considered exempt software, the following elements must be present:

A) Preparation or selection of the program for the customer's use requires an analysis of the customer's requirements by the vendor; and

B) The program requires adaptation by the vendor to be used in a specific work environment, e.g., a particular make and model of a computer using a specified input or output device.

2) Custom computer programs do not include "canned" or prewritten computer programs held for general or repeated sale or lease. Modification of an existing prewritten program to meet the customer's needs is custom software. If modified software is held for general or repeated sale or lease, it is canned software. Custom software means the software which results from real and substantial changes to the operational coding of canned or pre-written software in order to meet the specific individualized requirements of the purchaser for his limited or particular use.

3) The selection of pre-written or canned programs or program modules assembled by the vendor into a software package does not constitute custom software unless real and substantial changes are made to the program or creation of program interfacing logic. * * * " 86 Ill.Admin.Code §130.1935.

The Department contends that the taxpayer did not provide sufficient evidence to prove that it sold custom software. The Department argues that the taxpayer was in full control of its programming code and should have maintained a record of the software as it existed prior to its modification in order to compare it to the programming code that was sold to the customer. The

Department contends that without this level of proof, the Department's determination must be upheld.

In addition, the Department argues that even if the taxpayer's testimony is given some weight, there remain serious probative flaws because the testimony lacked "the necessary clarity." The Department notes that Ms. Jennie Doe provided estimates of the percentage of the program code that she changed in order to satisfy the particular needs of a customer. The Department contends that this testimony failed to pin down whether a software sale to a particular customer required real and substantial changes to the existing programming code.

The Department argues that the pervasive lack of clarity in the taxpayer's testimony, by itself, prevents the taxpayer from meeting its burden of proof. The Department states that the taxpayer never described or showed what a full sale consisted of, although Ms. Jennie Doe had mentioned that one sale consisted of several "programs" (Tr. p. 179) that ultimately made up one "program." (Tr. p. 186) The Department states that the taxpayer showed printouts of programs that were allegedly the result of alterations of canned code, and the taxpayer would "cut and paste" from other programs to create the product sold. The Department contends that the taxpayer made regular reference to the original code being created in 1979, which makes it unclear as to the years during which the changes were made.

Furthermore, the Department argues that none of the taxpayer's evidence is relevant to the issue of whether the canned programming code was changed in a real and substantial manner in order to be considered custom software. The Department states that the bulk of the taxpayer's argument appeared to be that each customer required individualized adaptation of the software to its business activities. The Department claims that the taxpayer's lengthy discussion tends to answer only two of the elements in the definition of custom software: (1) whether the software

required an analysis of the customer's requirements by the vendor, and (2) whether it requires adaptation by the vendor to be used in a specific work environment.

The Department contends that the only reliable evidence on this issue was the auditor's testimony that her examination of the sample of customers revealed an insufficient need for the adaptation of standard software. The Department argues that the auditor's conclusion is not surprising because many canned software programs contain sufficient adaptability to accommodate nearly an infinite variation of business models. The Department states that applications in retail software programs do not need to be re-programmed, but simply need to be activated. The Department compares the taxpayer's software to Microsoft Word, which is the "paradigm for canned software" because the installation and enabling of applications do not require the user to modify the basic programming code.[3] The Department states that a user can spend hours installing Word onto a computer and several hours every week or month updating settings, templates, macros, and preferences.

The taxpayer argues that the software that it sold was custom software. The taxpayer claims that it proved the software was custom-made by its records, documentation, programming explanations, and testimony. Ms. Jennie Doe gave testimony concerning the percentage of changes that she made to the programs and the amount of time that she spent making those changes. She classified the programs into four categories and testified that all of the programs fit into these categories. The percentage of change to the software ranged from 60 to 100 percent, and she spent many hours making the changes.

The taxpayer argues that the Department failed to provide any testimony that the software was not customized. The taxpayer claims that the burden of proof with regard to the correctness

[3] As an example, the Department states that Word allows a user to set it up so that it will incorporate an individual's name, a company name, the date opened, page numbers, filing terminology, or letterhead. It also allows the user to establish default font

of the returns shifted to the Department because the audit was unreasonable. The taxpayer also contends that it presented sufficient evidence to overcome the Department's prima facie case, and therefore the burden shifted back to the Department. In addition, the taxpayer argues that it is not required to prove its claim to the exemption because it was not in possession of its books, records, and documentation that would prove its entitlement to the exemption. The taxpayer claims that the Department was in possession of the software documentation and had ample opportunity to study the software but did not do so. The taxpayer argues that the Department failed to meet its burden of proving that the software was not custom software, and the liability against the taxpayer should be dismissed.

In addition, the taxpayer argues that it met the two requirements of the Department's regulation concerning custom software. The taxpayer states that it analyzes the customer's requirements in order to prepare or select the program, and the program requires adaptation by the taxpayer to be used in a specific work environment. The taxpayer states that it provided lengthy testimony concerning the analysis of customer needs, and the taxpayer sent a questionnaire to each customer in order to customize the software to its particular operation. Also, the taxpayer states that the software was adapted to work in specific work environments. Changes were made to adjust the software to trucking, grain storage, and other specific environments. The applications would not run and could not be installed without the taxpayer.

Finally, the taxpayer argues that the Department's comparison of this software to Microsoft Word is inappropriate. The taxpayer claims that unlike Word, the taxpayer installs a unique operating system called ABC, and the customer is not given the software program. The purchaser cannot transfer the software to anyone, and the software only runs on one machine.

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types and sizes, margins, columns, tables, colors, and a variety of templates or macros. Spelling and grammar checkers can also be modified to include terms of art.

The taxpayer contends that it takes a special operating system and a "plug" to install the software and someone from the taxpayer's business must help the customer install the program. The taxpayer's programs are only sold through a distributor and not off-the-shelf. Ms. Jennie Doe testified that she changed the program approximately 60 to 100% for each customer so that the applications met the needs of the customers. Ms. Jennie Doe stated that the installation and training for the software requires over eight hours of on-site work. For all these reasons, the taxpayer claims it is entitled to the exemption.

The taxpayer's contention that the Department must prove that the software is not customized is without merit. As previously stated, the auditor's method was reasonable and the Department's corrected returns establish its prima facie case. The taxpayer then has the burden of proving that the software was customized. Although the taxpayer argues that the Department was in possession of its books and records and the taxpayer could not prove its case, there was no evidence presented at the hearing that the taxpayer was denied access to its information. In fact, the taxpayer actually presented a number of documents from its books and records. In addition, the taxpayer always had the right to subpoena all of its documents from the Department through discovery.

Nevertheless, the taxpayer presented sufficient evidence at the hearing to meet its burden of proving the software is customized. As the Department contends, the best evidence probably would have been for the taxpayer to provide a record of the software as it existed prior to its modification in order to compare it to the programming code that was sold to the customer. However, nothing in the statute or regulations requires this level of proof.

The Department's regulation concerning computer software provides that two elements must be present in order for software to be exempt from taxation: (1) the preparation or selection

of the program for the customer's use requires an analysis of the customer's requirements by the vendor, and (2) the program requires adaptation by the vendor to be used in a specific work environment. These are the only two elements that are required by the regulation. The regulation further provides, however, that "[c]ustom software means the software which results from real and substantial changes to the operational coding of canned or pre-written software in order to meet the specific individualized requirements of the purchaser for his limited or particular use." 86 Ill.Admin.Code §130.1935(c)(2). Although it is not clearly stated, it appears that this requirement is part of the second element necessary for custom software. In other words, in determining whether the program has been adapted by the vendor to be used in a specific work environment, it must be determined whether the software was the result of real and substantial changes to the operational coding.

Admittedly, the taxpayer's evidence was both confusing and disorganized. The taxpayer's counsel stated at one point that he did not understand anything that his client was saying. (Tr. p. 364) At another point he stated that he was eliciting certain testimony so that he could understand, for his own knowledge, his client's functions. (Tr. p. 166)

Notwithstanding the taxpayer's confusing presentation, the record contains adequate evidence to support a finding that the software was custom software. First, the preparation or selection of the programs for the customer's use required an analysis of the customer's requirements by the taxpayer. Prior to installing the programs, the taxpayer would ask the customer a series of questions in order to determine how the customer conducted its business. The goal was to understand the customer's business in order to fit the software to the customer's needs. The process of determining what the customer needed would take up to three weeks.

In addition, the programs required adaptation by the taxpayer in order to be used in the customer's specific work environment. Most of the software programs that the taxpayer sold would not operate on ABC without first being modified by the taxpayer. The taxpayer explained the operations of a few of its customers and explained how the programs needed to be changed in order to fit the customers' needs. The taxpayer gave the percentage of modifications that were done to the code that consisted of either code that was rewritten or added to the original programs. Most of the percentages were well over 50%. The taxpayer also provided the amount of time that was spent making these changes; the amount of time spent on each customer was significant. The taxpayer indicated that these types of modifications were done for all of its customers. Although the taxpayer made references to the original program that was created in 1979, which may have caused confusion concerning when the changes were made, when the taxpayer discussed the changes, there were references to the invoices that the auditor relied upon in issuing the assessment. These references indicated that the changes were made during the audit period.

As stated earlier, in determining whether the changes to the code were real and substantial, it would have been useful to have compared the original program with the final program that was sold to the customer. Even with that information, however, one line of code could have taken a significant amount of time to change. The amount of time spent making the changes is therefore relevant in determining whether the changes are real and substantial. Also, the price of the initial software before the changes were made would have been relevant in comparison to the price of the final product. Under cross-examination, the taxpayer could not provide the price of the original program. Nevertheless, the lack of this information is not fatal

to the taxpayer's case. The evidence provided indicates that the taxpayer made real and substantial changes to the programming code to warrant the exemption.

Issue Five

The Department's regulation concerning sales of property to out-of-state customers provides in part as follows:

> "The [ROT] tax does not extend to gross receipts from sales in which the seller is obligated, under the terms of his agreement with the purchaser, to make physical delivery of the goods from a point in this State to a point outside this State, *** provided that such delivery is actually made." 86 Ill.Admin.Code, ch. 1, §130.605(b)

The regulation further provides that in order to establish that gross receipts are exempt on the basis of out-of-state deliveries, the seller is required to retain proof that there was such an agreement and a bona fide delivery outside this state. 86 Ill.Admin.Code, ch. 1, §130.605(e).

The taxpayer's exhibit number 11 is a group of invoices for sales that the taxpayer contends are out-of-state sales. Several of the invoices are from 1991, which is outside the audit period and therefore those invoices are not relevant. Of the remaining invoices, for all but three of the invoices the Department determined that the sales were out-of-state and granted the taxpayer the exemption. (See Dept. Ex. #2, Taxpayer Ex. #11). In its brief, the Department conceded that it should have allowed the exemption for the final three invoices, numbers 356, 518, and 541. These invoices represent total sales of $3,779.50, and the Department concedes that this should be subtracted from the total taxable sales that are the basis for the audit liability. With this concession, there is nothing further to resolve concerning this issue.

Issue Six

The portion of the ROTA that was in effect during the audit period concerning an exemption for farm machinery and equipment provided as follows:

> "Exemptions. Gross receipts from proceeds from the sale of the following tangible personal property are exempt from the tax imposed by this Act: * * *

(2) Farm machinery and equipment, both new and used, including that manufactured on special order, certified by the purchaser to be used primarily for production agriculture or State or federal agricultural programs, including individual replacement parts for the machinery and equipment, and including machinery and equipment purchased for lease, but excluding motor vehicles required to be registered under the Illinois Vehicle Code. * * * (35 ILCS 120/2-5(2).)

This provision of the ROTA was amended effective June 30, 1998 and added the following paragraph:

> "Farm machinery and equipment shall include precision farming equipment that is installed or purchased to be installed on farm machinery and equipment including, but not limited to, tractors, harvesters, sprayers, planters, seeders, or spreaders. Precision farming equipment includes, but is not limited to, soil testing sensors, computers, monitors, software, global positioning and mapping systems, and other such equipment." (35 ILCS 120/2-5(2).)

The taxpayer's exhibit number 12 includes three invoices that total $10,490.00 and are for the sale of yield monitors to the taxpayer's customers. The Department contends that under the law that was in effect during the audit period, the yield monitors are not tax-exempt. The Department states that the yield monitors would be exempt under the paragraph that was added effective June 30, 1998, but because this paragraph was not part of the statute before that date, the Department claims that the exemption should not be allowed.

The taxpayer argues that the amended statute supports its position that the tax on the yield monitors is improper. The taxpayer notes that the auditor admitted that the sale of yield monitors would not now be taxable. The taxpayer claims that because it timely protested the tax on the monitors after the 1998 amendment was in effect, this allowed the taxpayer to preserve the issue of the taxability of the monitors, and they should not be taxed because the current law allows an exemption.

The question of whether statutory amendments should be given retroactive application was recently addressed by our Illinois Supreme Court in Commonwealth Edison Company v. Will County Collector, 196 Ill.2d 27 (2001). The court adopted the test for retroactive

application that was set forth by the United States Supreme Court in Landgraf v. USI Film Products, 511 U.S. 244 (1994). The Commonwealth Edison court set forth the Landgraf test as follows:

> "[I]f the legislature has clearly indicated what the temporal reach of an amended statute should be, then, absent a constitutional prohibition, that expression of legislative intent must be given effect. However, when the legislature has not indicated what the reach of a statute should be, then the court must determine whether applying the statute would have a retroactive impact, i.e., "whether it would impair rights a party possessed when he acted, increase a party's liability for past conduct, or impose new duties with respect to transactions already completed." [citation] If there would be no retroactive impact, as that term is defined by the court, then the amended law may be applied. [citation] If, however, applying the amended version of the law would have a retroactive impact, then the court must presume that the legislature did not intend that it be so applied. [citation]" Commonwealth Edison at 38.

After the decision in Commonwealth Edison, the First District Appellate Court added as part of this rule that if an amendment only clarifies existing law, then the amendment should be applied to pending cases. In re T.T., 322 Ill.App.3d 462, 465 (1st Dist. 2001).

The amendment in this case is simply a clarification of existing law. Before the amendment was enacted, the ROTA allowed an exemption for farm machinery and equipment and provided a short list of what was included in that term. The amendment provides additional items that should be included in the list of items that are exempt. The amendment clarifies the application of the statute and reduces speculation concerning what items are exempt. As the court in In re T.T. found, when an amendment simply clarifies existing law, it should be applied retroactively. In re T.T. at 465-466.

The legislative history of this amendment also supports this conclusion. Although there was not much discussion concerning this amendment in the House, there was some discussion in the Senate concerning the purpose of the change. The senators debated the reasons for the amendment, and Senator Sieben stated that the amendment "adds definitional language that we

worked out with the Department of Revenue adding definitions for the sales tax exclusions on various precision agriculture equipment used today for production agriculture." (Senate Transcript, 90th General Assembly, May 14, 1998, p. 101) On the date that the amendment was passed, Senator Cullerton stated as follows: "[B]y passing this, we would keep the language which **clarifies** that there's a sales tax exemption when farmers go to purchase computers used primarily for farm-related industries. Is that correct?" (emphasis added, Senate Transcript, 90th General Assembly, May 22, 1998, p. 136) The response was yes, and the bill was passed. As stated in the legislative history, the amendment is simply a clarification of existing law; it should be applied retroactively. The yield monitors are tax-exempt.

Issue Seven

Taxpayer's exhibit number 15 includes invoices dated from April 1, 1993 to February 7, 1994 that were sent to one of the taxpayer's customers, Joe Blow Grove Grain Company ("Joe Blow Grove"). The taxpayer contends that the invoices are for reimbursements for insurance payments for one of the taxpayer's employees, Jane Doe. Ms. Doe left the employment of the taxpayer and went to work for Joe Blow Grove. The taxpayer contends that Ms. Doe could not immediately be included on Joe Blow Grove's insurance, so the taxpayer kept Ms. Doe on its insurance and invoiced Joe Blow Grove for the cost.

The Department argues that the taxpayer did not present sufficient evidence to overcome the Department's prima facie case on this issue. The Department states that the taxpayer only presented testimony from Ms. Jennie Doe and copies of the invoices to prove its claim. The Department contends that the taxpayer should have presented some other documentary evidence to support its position. The Department argues that documentary proof of a reimbursement for a health insurance premium must be provided by the taxpayer. The Department contends that the taxpayer failed to produce an insurance company bill or a cancelled check written to an

insurance company in order to prove its contention. Without such evidence, the Department claims that the payments received from Joe Blow Grove are not exempt.

The taxpayer argues that it does not have the burden of proof when it does not have possession of its books, records, and documentation necessary to prove its claim. The taxpayer states that the Department seized its records and still has possession of them. In addition, the taxpayer notes that it presented testimony from Ms. Jennie Doe and supporting invoices that prove its contention. The taxpayer contends that by producing this evidence, the burden shifted back to the Department, and the Department failed to show that the reimbursements are taxable.

As previously stated, the taxpayer's contention that it does not have the burden of proof because it did not have possession of its books and records is totally without merit. Even though that contention is without merit, the evidence presented is sufficient to find that the charges were reimbursements for insurance. In addition to Ms. Jennie Doe's testimony, the taxpayer presented ten invoices that were issued to Joe Blow Grove Grain. Each invoice has a description of the sale. Under the description column, the invoices have either "insurance," "insurance for Sally's premium," or "insurance for Jane Doe." Two of the amounts are for $207.65, five are for $228.35, and three are for $271.35. These descriptions and amounts give credibility to the testimony that the payments are reimbursements for insurance. These reimbursements should be exempt from tax.

Issue Eight

The taxpayer's exhibit number 13 consists of invoices that the taxpayer claims are for "hardware support," and exhibit number 14 are invoices that it contends are for "software support." The taxpayer argues that each of those payments was for labor, which is not taxable as a retail sale.

The Department raises the same arguments that it raised in response to the alleged insurance reimbursements. The Department contends that the taxpayer failed to present sufficient evidence to overcome the Department's prima facie case. The Department states that the hardware and software support invoices could have been supplemented with a billing or memorandum that showed whether tangible personal property was transferred in connection with the support function. The Department argues that "support" seldom consists exclusively of labor. The Department contends that without additional evidence, the payments for "support" are not tax exempt.

The taxpayer argues that it presented testimony and invoices to support its contention, and therefore the burden of proof shifted to the Department. The taxpayer contends that this is especially true because the audit was unreasonable and arbitrary. Also, the taxpayer again raises the contention that it did not have the burden of proof because it was not in possession of its books and records. The taxpayer claims that it produced the best evidence that it had, which was testimony and invoices, and the Department failed to prove that the invoices were not for labor.

As stated earlier, the taxpayer's contention that it does not have the burden of proof on this issue is without merit. With respect to the invoices that the taxpayer claims were for "hardware support," the taxpayer has failed to meet its burden. The invoices actually state "hardware maintenance" in the description column. Several of the invoices are dated during 1991, which is outside the audit period, and they are, therefore, irrelevant. Of the remaining invoices, the amounts charged are for yearly service contracts. The amounts charged, however, seem to be unusual fees for service contracts. For example, invoice number 436, dated November 24, 1992, shows a hardware maintenance fee for the period of 11/15/92 to 11/14/93 in the amount of $3,240.23. Invoice number 513 shows a fee of $2,908.40. It is reasonable to

conclude that because these are not consistent or round amounts, items such as replacement parts or equipment were included in the charges.

The taxpayer's testimony concerning hardware maintenance does not clear up this concern. Although the taxpayer testified that hardware maintenance fees depended on the hardware that the customer had (Tr. p. 214), it is not clear from the record what exactly makes up the fee. For example, Ms. Jennie Doe testified that some customers purchase a spare printer in case their printer breaks. The customer will then send the broken printer to the taxpayer so that it can be fixed and sent back to the customer. (Tr. p. 214) If the broken printer requires new parts, it is not clear whether the customer is separately charged for that.

Also, Ms. Jennie Doe testified that during the 1980's, most of hardware maintenance was for parts. (Tr. p. 138) Then she testified that during the 90's, the price of parts came down so much that labor was the main concern. (Tr. p. 138) She said that the environment of agricultural businesses is very dirty and the parts need to be cleaned. She said, "I don't believe that during those – that three-year period that any parts were replaced by us on hardware maintenance." (Tr. pp. 139-140) This testimony is not unequivocal; it is not clear from the evidence that parts were not included as part of the charge for hardware maintenance. Because the taxpayer has failed to meet its burden of proof on this issue, the maintenance charges are taxable.

With respect to the software support charges, the taxpayer has presented sufficient evidence to support its claim. The taxpayer provided many invoices that show charges for yearly software support. Some of the invoices are dated during 1991, which is outside the audit period, and, therefore, these invoices are irrelevant. Of the remaining invoices, the taxpayer charged one of the following amounts for yearly software support services: $600, $750, $900, $1050, or $1200. These round figures support the taxpayer's claim that these payments did not include

payments for parts. The taxpayer's witness testified that the charge for software support covers phone calls, trips, labor, and training related to the use of the software. This testimony, along with the supporting invoices, supports the claim that the charges for software support are not taxable.

Issue Nine

The final issue in this case concerns whether the fraud penalty should be imposed. The taxpayer's intent for purposes of the fraud penalty may be shown by circumstantial evidence. Vitale v. Department of Revenue, 118 Ill.App.3d 210, 213 (3rd Dist. 1983). The Department presented evidence that for the years 1992 and 1993, the taxpayer collected approximately $25,000 in taxes but only remitted $139 to the Department. This is sufficient evidence to impose the fraud penalty.

Recommendation:

For the foregoing reasons, it is recommended that the taxpayer's sales of software are exempt as sales of custom software. Also, the amount of $3,779.50 should be subtracted from the total taxable sales for out-of-state sales. The amount of $10,490 should be subtracted from the total taxable sales for the sales of yield monitors that are exempt because they qualify for the farm equipment exemption. The amount received as reimbursement for an employee's insurance premiums should be subtracted from total taxable sales, and the amount received for software support should be subtracted from total taxable sales. The taxpayer is not entitled to a deduction for hardware maintenance payments. Finally, the fraud penalty should be imposed.

_____

Linda Olivero
Administrative Law Judge

Enter: August 27, 2002